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91-698

Supreme Court, U.S.
FILED
OCT 11 1991
OFFICE OF THE CLERK

No. ____

IN THE

Supreme Court of the United States

October Term, 1991

BOARD OF TRUSTEES OF THE
PUBLIC EMPLOYEES' RETIREMENT FUND
OF THE STATE OF INDIANA,

Petitioner,

v.

LOUIS W. SULLIVAN, M.D., Secretary of
Health and Human Services, and
UNITED STATES OF AMERICA,

Respondents.

Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

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[October 11, 1991]

QUESTION PRESENTED

Whether the federal government should be estopped from asserting that a 100% federally funded program had not been approved as a separate entity for retirement purposes when it was so established by federal request?

LIST OF PARTIES

The following were parties to the proceedings in the Seventh Circuit:

Plaintiff Appellant: The Board of Trustees of the Public Employees' Retirement Fund of the State of Indiana.

Defendant Appellee: Louis W. Sullivan, M.D., as Secretary of the Department of Health and Human Services of the United States of America and the United States of America.

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No. ____

IN THE

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BOARD OF TRUSTEES OF THE
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OF THE STATE OF INDIANA,

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v.

LOUIS W. SULLIVAN, M.D., Secretary of
Health and Human Services, and
UNITED STATES OF AMERICA,

Respondents.

Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

The petitioner respectfully petitions this Court to issue a writ of certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit entered in *Board of Trustees of the Public Employees' Retirement Fund of the State of Indiana v. Louis Sullivan, Secretary of Health and Human Services and the United State of America*, No. 90-3010 on July 15, 1991. The judgment affirmed the United States District Court for the Southern District of Indiana which directed the petitioner to repay the United States after partial satisfaction the sum of $9,520,584.05.

OPINIONS BELOW

The decision of the Seventh Circuit on July 15, 1991 is reported at 936 F.2d 988 (7th Cir. 1991) and is reprinted in the Appendix at page 1.

The decision of the District Court of June 28, 1990 has not been reported and is reprinted in the Appendix at page 9.

The decision of the Grant Appeals Board of the Department of Health and Human Services of June 24, 1982 upholding the retirement cost disallowance is reprinted in the Appendix at page 41.

JURISDICTION

The judgment to be reviewed was entered on July 15, 1991. No petition to rehear the judgment was filed.

This Court has jurisdiction to review the judgment pursuant to 28 U.S.C. § 1254(1).

CONSTITUTION, FEDERAL STATUTE AND REGULATION INVOLVED

Article I, §9, Clause 7 of the Constitution of the United States provides:

> No money shall be drawn from the Treasury, but in consequence of appropriations made by law.

42 U.S.C. § 502(a) provides:

> The Secretary of Labor shall from time to time certify to the Secretary of the Treasury for payment to each State which has an unemployment compensation law approved by the Secretary of Labor under the

Federal Unemployment Tax Act, such amounts as the Secretary of Labor determines to be necessary for the proper and efficient administration of such law during the fiscal year for which such payment is to be made including 100 percent of so much of the reasonable expenditures of the State as are attributable to the costs of the implementation and operation of the immigration status verification system described in section 1320b-7(d) of this title. The Secretary's determination shall be based on (1) the population of the State; (2) an estimate of the number of persons covered by the State law and of the cost of proper and efficient administration of such law; and (3) such other factors as the Secretary of Labor finds relevant. The Secretary of Labor shall not certify for payment under this section in any fiscal year a total amount in excess of the amount appropriated therefor for such fiscal year.

5 U.S.C. § 706 provides:

To the extent necessary to decision and when presented, the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action. The reviewing court shall-

(1) compel agency action unlawfully withheld or unreasonably delayed; and

(2) hold unlawful and set aside agency action, findings, and conclusions found to be-

(A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;

(B) contrary to constitutional right, power, privilege, or immunity;

(C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right;

(D) without observance of procedure required by law;

(E) unsupported by substantial evidence in a case subject to sections 556 and 557 of this title or otherwise reviewed on the record of an agency hearing provided by statute; or

(F) unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court.

In making the forgoing determinations, the court shall review the whole record or those parts of it cited by a party, and due account shall be taken of the rule of prejudicial error.

45 C.F.R. Part 74, Appendix C (October 1, 1979) (FMC Circular 74-4) reads as follows, in pertinent part:

1. Objectives. This appendix sets forth principles for determining the allowable costs of programs administered by State and local governments under grants from and contracts with the Federal Government. The principles are for the purpose of costs determination and are not intended to identify the circumstances or dictate the extent of Federal and State or local participation in the financing of a particular grant. They are designed to provide that federally assisted programs bear their fair share of costs recognized under these principles, except where restricted or prohibited by law. No provision for profit or other increment above cost is intended.

* * *

1. *Factors affecting allowability of costs.* To be allowable under a grant program, costs must meet the following general criteria: ...

b. Be consistent with policies, regulations, and procedures that apply uniformly to both federally assisted and other activities of the unit of government of which the grantee is a part.

STATEMENT OF THE CASE

Facts

The Seventh Circuit "simplif[ied] the facts to lay bare the nature of the dispute":

> Indiana has a defined-benefit retirement plan (the Public Employees' Retirement Fund of the State of Indiana, "PERF" for short) for all state and municipal employees. Indiana treats its Employment Security Division (IESD) as a separate entity for purposes of contributions to PERF. The IESD is indeed an unusual part of state government, because the federal government reimburses 100% of the costs of its administration of the unemployment compensation program, including the full salaries and benefits of state employees.
>
> * * *
>
> Retirements benefits in Indiana follow the standard pattern for workers in the public sector: payments depend on the number of years of service and the average salary during the years preceding retirement. The same formula is used to determine benefits of all state employees, including those of the IESD. An identical formula for benefits does not imply equal costs. Turnover has been slower in the IESD than elsewhere, so its retirees have both more years of service and higher terminal salaries

than do workers at other agencies. Both the additional years and the higher salaries translate to higher pension benefits.

At the beginning of the audit period there were three categories of contributing agencies: municipal governments, the IESD, and other state agencies. If PERF's calculations showed that any of these three categories were underfunded (that is, if the capital balance of the account plus current contributions did not match the present value of promised benefits), PERF required the municipality or agency to increase the rate of contributions to eliminate the underfunding by the end of a fixed number of years. That number was 30 years for the IESD and other state agencies, 15 years for municipalities.

* * *

In 1972, when PERF's actuaries determined that the IESD's account would be exhausted in 3 1/2 years, Indiana began charging the IESD a higher rate, which would end the underfunding in 15 years.

Board of Trustees v. Sullivan, 936 F. 2d 988, 990 (7th Cir. 1991) Appendix 2, 3.

IESD was established with a separate retirement system *at the request* of the federal government. This is seen in a 1959 federal government memorandum which incorporated a 1945 letter also from the federal government:

> We agree with the position taken in the 1945 Borus letter, that the ES agency liability be calculated separately from all other units. We recommend that this be continued. . . . Consequently, the ES account will in fact remain a separate individual retirement system which is part of a statewide system only for administrative purposes. This will assure that funds

> granted by the Federal Bureau of Employment Security for payment of the ES agency's retirement costs will be used solely for that purpose.

Appendix 45.

The Grant Appeals Board of Health and Human Services, whose decision has been under review, discounted this correspondence and disallowed the cost allocation for the portion of retirement costs that exceeded the rate for other state agencies for the reason that IESD was not a municipality. The Grant Appeals Board concluded:

> In conclusion, we find that the 1959 memorandum recognized that IESD's liability should be calculated separately, but IESD is not a separate legal entity. In addition, there is no other evidence in the record to support the conclusion the IESD is sufficiently separate as a legal entity to justify inconsistent treatment under the cost principles. On the contrary, the evidence shows that for all practical purposes IESD was a State department. Therefore, we find that IESD was not a separate legal entity.

Appendix 48.

The Grant Appeals Board upheld the retirement cost disallowance in the full audit amount of $5,049,837, but the IESD account had only $6,587,648. The Seventh Circuit eventually affirmed writing:

> Indiana wants money from the Treasury; it invokes estoppel to prevent the federal government from reducing current payments in order to make up what HHS believes to have been overpayments in the 1970s. *OPM v. Richmond*, __ U.S. __, 110 S.Ct. 2465, 2471-76, 100 L.Ed.2d 387 (1990), holds that courts may not alter statutory conditions for the drawing of public funds through the formula of estoppel.

Appendix 4

Proceedings Below

The Board commenced this action by filing its complaint for judicial review and declaratory judgment on July 14, 1982. After briefing and oral argument on February 12, 1985, the District Court filed its memorandum of decision on June 28, 1990. After calculation of prejudgment interest, judgment was entered on August 9, 1990 in the amount of $11,360,367.05 (App. 36). On October 17, 1990, the parties reached a stipulation for partial payment of $1,867,189.23; this represents the portion of the judgment to the non-IESD cost disallowance. (App. 38). PERF pursued an appeal to the Seventh Circuit and its opinion was handed down July 15, 1991.

REASON FOR GRANTING THE WRIT

THIS COURT HAS NOT DECIDED THAT ESTOPPEL MAY NEVER RUN AGAINST THE FEDERAL GOVERNMENT YET HAS ALWAYS STOPPED SHORT OF APPLYING THE DOCTRINE.

THIS CASE IMPLICATES IMPORTANT QUESTIONS ABOUT THE REMEDIAL POWERS OF A FEDERAL COURT TO REVERSE ARBITRARY AND CAPRICIOUS GOVERNMENT CHANGES IN COURSE.

On its three most recent occasions to directly consider the question, this Court has refused to rule out the possibility that estoppel may never run against the federal government. In *Schweiker v. Hansen*, 450 U.S. 785 (1981), in a per curiam decision, this Court observed that it:

> ...has never decided what type of conduct by a government employee will estop the Government from insisting upon compliance with valid regulations.

Ibid., at 788. In *Heckler v. Community Health Services of Crawford County*, 467 U.S. 51 (1984), Justice Stevens wrote:

> We have left the issue open in the past and do so again today. Though the arguments the Government advances for the rule are substantial, we are hesitant, when it is unnecessary to decide this case, to say that there are no cases in which the public interest in ensuring that the government can enforce the law free from estoppel might be outweighed by the countervailing interest of citizens in some minimum standard of decency, honor, and reliability in their dealings with their Government.

Ibid., at 60, 61. In *Office of Personnel Management v. Richmond*, ___ U.S. ___ , 110 S.Ct. 2465 (1990), Justice Kennedy also stopped short, saying:

> We leave for another day whether an estoppel claim could ever succeed against the Government.

Ibid., 110 S.Ct. at 2471.

Federal Crop Ins. Corp. v. Merrill, 332 U.S. 380 (1947), is the leading authority for the rule that courts "must observe the conditions defined by Congress for charging the public treasury". *Ibid.*, at 385. *Office of Personnel Management, supra*, relied on the Appropriation Clause of the Constitution, Art. I, § 9, Cl. 7 to deny disability benefits to a person who relied on advice which caused him to fail statutory eligibility requirements.

This rule has achieved a certain clarity when statutory eligibility for benefits or entitlements are in issue. In *Schweiker v. Hansen, supra*, a qualified social security applicant failed to comply with a statutory requirement to make a written application, despite having been incorrectly told by a representative she was not eligible. In *Lyng v. Payne*, 476 U.S. 926 (1986), decided on due process grounds, a farmer

claimed he was not adequately informed of a regulatory deadline to apply for disaster benefits.

Nevertheless, this Court has sidestepped the estoppel argument on several occasions and thwarted the government's attempt to establish a sweeping rule. In *United States v. Locke*, 471 U.S. 84 (1985), a claim holder followed an incorrect government publication giving the application deadline and filed its renewal one day late; this Court reversed on the due process issue and remanded. Justice O'Connor concurred:

> In this regard, I merely note that in my view our previous decisions do not preclude application of estoppel in this context.

Ibid., at 112. (The case was never to be heard from again). In *United States v. Pennsylvania Industrial Chemical Corp.*, 411 U.S. 655 (1973) the Court held the government to its position based on "traditional notions of fairness inherent in our system." *Heckler, supra*, 467 U.S. at 67, (Rehnquist, Burger concurring). In *Moser v. United States*, 341 U.S. 41 (1951) a loss of citizenship was prevented on the basis of an "absence of a knowing and intentional waiver of the right to citizenship." *Heckler, supra*, 467 U.S. at 67 (Rehnquist, Burger concurring). One commentator has studied the "no estoppel" decisions and has written:

> . . .[M]any lower courts think they have [seen an estoppel],[1]applying elements of equitable estoppel to set aside agency action in violation of agency laws, while evading the general "no estoppel" principle by declining to characterize their analysis as estoppel.

Raven-Hansen, Regulatory Estoppel: When Agencies Break Their Own "Laws," 64 Texas Law Review 1, 3 (1985).

This case presents a situation where there is no question as to the authority of the federal officer who counseled, in writing, the establishment of a separate retirement system for IESD in 1945 or 1959. There is no question of meeting an application or entitlement deadline established by statute or regulation. The Appropriation Clause is not implicated because Congress directed the Secretary, through 42 U.S.C. §502, to award grants for the proper and efficient administration of unemployment programs by the States. Nor is there a conflict between private interest and public policy.

Instead, this case presents an opportunity to directly study the law on estoppel against the government in the context of "arbitrary and capricious" actions without the Constitutional limitations imposed by the Court's recent decisions. This standard of review has been the check on an agency's fulfillment of Congressional policy. *Atchison, T. & S.F.R. Co. v. Wichita Board of Trade*, 412 U.S. 800, 806 (1973). Where an agency cannot give a principled reason for reversal of position, a question of estoppel may arise. *See*, Davis, *Administrative Law in the Seventies*, 399-404 (1976) cited in *Local 777, Democratic Union Org. Comm. v. National Labor Relations Board*, 603 F.2d 862, 872 (D.C. Cir. 1978) and *Schweiker v. Hansen*, 450 U.S. at 791, (Marshall, Brennan dissenting). Important reliance interests are jeopardized by

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[1] Referring to Justice Marshall's "we will know an estoppel when we see one" from *Schweiker v. Hansen*, 450 U.S. 785, 792.

the retroactive effect of the government's decision. *Atchison, supra*, cited in *Heckler, supra*, 467 U.S. at 60, n. 12. By leaving only $1.5 million in the IESD account after the audit, the government returns it to its underfunded condition of the 1970s which is at odds with the Congressional purpose of 42 U.S.C. § 502 to foster a proper and efficient unemployment program in which the federal government bears its "fair share of costs."[2] Otherwise, the application of the rule defeats the purpose. As one scholar has written,

> [T]he same logic that requires the formulation of a rule to be defeasible in the service of its pupose would also require that purpose to be defeasible in the service of the purpose behind *it*.

Schauer, Formalism, 97 Yale Law Journal 509, 534 (1988).

CONCLUSION

The Writ of Certiorari should be granted.

Respectfully submitted,

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[2]/45 C.F.R. Part 74, Appendix C.

APPENDIX

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Decision of the Grant Appeals Board Department of Health and Human Services A-41

[936 F. 2d 988 (7th Cir. 1991)]

In the
United States Court of Appeals
For the Seventh Circuit

No. 90-3010

BOARD OF TRUSTEES OF THE PUBLIC EMPLOYEES' RETIREMENT FUND OF THE STATE OF INDIANA,

Plaintiff-Appellant,

v.

LOUIS W. SULLIVAN, Secretary of Health and Human Services, and UNITED STATES OF AMERICA,

Defendants-Appellees.

Appeal from the United States District Court
for the Southern District of Indiana, Indianapolis Division.
No. 82-1520-C—**James E. Noland,** *Judge.*

ARGUED APRIL 19, 1991—DECIDED JULY 15, 1991

Before EASTERBROOK, MANION, and KANNE, *Circuit Judges.*

EASTERBROOK, *Circuit Judge.* When the federal government pays its share of the costs of a cooperative state-federal program, it underwrites part of the fringe benefits of the employees who carry out the program on behalf of the state. It is difficult, however, to define the proper share of the federal government. States are tempted to set up accounting systems that shift a disproportional share of the total costs of their employees to the federal government. Understanding this incentive, the federal

government inspects the books to protect its interest, and it insists on a rule of neutrality: the state may not allocate to federal programs costs greater than those the state charges to itself for an equivalent slice of the employee's time.

The federal government audited Indiana's reimbursement for 1971-78 and concluded that the state made retirement contributions on behalf of federally-funded workers exceeding those on behalf of workers paid from state coffers. We simplify the facts to lay bare the nature of the dispute. Indiana has a defined-benefit retirement plan (the Public Employees' Retirement Fund of the State of Indiana, "PERF" for short) for all state and municipal employees. Indiana treats its Employment Security Division (IESD) as a separate entity for purposes of contributions to PERF. The IESD is indeed an unusual part of state government, because the federal government reimburses 100% of the costs of its administration of the unemployment compensation program, including the full salaries and benefits of state employees. 42 U.S.C. §§ 502(a), 1101(c)(1)(A). Reimbursement of administrative expenses began in 1935 as a carrot to states considering unemployment compensation programs.

Retirement benefits in Indiana follow the standard pattern for workers in the public sector: payments depend on the number of years of service and the average salary during the years preceding retirement. The same formula is used to determine benefits for all state employees, including those of the IESD. An identical formula for benefits does not imply equal costs. Turnover has been slower in the IESD than elsewhere, so its retirees have both more years of service and higher terminal salaries than do workers at other agencies. Both the additional years and the higher salaries translate to higher pension benefits.

At the beginning of the audit period there were three categories of contributing agencies: municipal governments, the IESD, and other state agencies. If PERF's

calculations showed that any of these three categories was underfunded (that is, if the capital balance of the account plus current contributions did not match the present value of promised benefits), PERF required the municipality or agency to increase the rate of contributions to eliminate the underfunding by the end of a fixed number of years. That number was 30 years for the IESD and other state agencies, 15 years for municipalities.

In 1972, when PERF's actuaries determined that the IESD's account would be exhausted in 3½ years, Indiana began charging the IESD a higher rate, which would end the underfunding in 15 years. This meant that the federal government, funding the IESD pensions, was paying a higher percentage of the wage bill than the state contributed for employees of other agencies. Disparity in assessment was only half of the story; the state legislature did not appropriate all of the money PERF sought for state-funded agencies. Appropriations fell short of the amount required to eliminate the underfunding even within 30 years. The conjunction of the different periods for achieving full funding with the failure of the legislature to appropriate the full sums PERF assessed produced:

Contribution Rates (% of gross payroll)

Fiscal Year	IESD	State
1972	13.77	4.98
1973	13.77	4.76
1974 Qs 1 & 2	12.45	4.01
1974 Qs 3 & 4	12.45	2.89
1975	10.16	3.62
1976	9.15	6.00
1977	8.54	6.00
1978	7.82	6.00

Federal auditors demanded in 1980 that PERF repay the difference, which with the sums attributable to a few other agencies came to more than $6 million. Indiana balked, and after losing in the highest administrative tribunal (the Departmental Appeals Board of the Department of Health

and Human Services) the state filed this action in 1982 against HHS seeking to block collection and prevent the government from reducing current payments in order to recoup. The United States eliminated any potential jurisdictional problem by intervening and making a counterclaim for the sum HHS had computed. The United States moved for summary judgment. Briefs were exchanged in March 1984, the case was argued in February 1985, and in June 1990 the district judge granted summary judgment in favor of the federal government.

Indiana contends that a memorandum written in 1959 on the topic of PERF's treatment of the IESD as a separate entity estops the United States to compare the IESD to other state agencies. The memo memorializes a meeting between PERF and regional officials of the Department of Labor; it refers to a letter written in 1945 by the head of the Department's office in Chicago. The 1945 letter and the memo could be read, as Indiana does, to accept full funding of the IESD's pension obligations even though other units of state government are underfunded; they could also be read, as the federal government does, to require comparable treatment of the IESD and other state agencies. No matter. Indiana wants money from the Treasury; it invokes estoppel to prevent the federal government from reducing current payments in order to make up what HHS believes to have been overpayments in the 1970s. *OPM v. Richmond*, 110 S. Ct. 2465, 2471-76 (1990), holds that courts may not alter statutory conditions for the drawing of public funds through the formula of estoppel.

According to 42 U.S.C. §502(a), states are entitled to "such amounts as the Secretary of Labor determines to be necessary for the proper and efficient administration" of the state's unemployment compensation program. Indiana wants a greater sum than the Secretary believes necessary for "proper" administration; to get it Indiana needs to address the legality of the Secretary's determination in 1982. Payments for the 1970s depend on the rules in force in the 1970s; it is not enough to contend that all

was settled by a subordinate's letter in 1945 and a memo to file in 1959. Perhaps the Secretary has the authority to bind the United States by contract, but Indiana does not contend that either the 1945 letter or the 1959 memo (which no federal official signed) is a contract. Section 502 contemplates annual determinations and authorizes the Secretary of Labor (acting in this case through an appellate tribunal of HHS) to establish criteria. Different Secretaries may have different views of what is "proper and efficient administration". Before making a dramatic change in the way it assessed the pension contributions of the IESD in 1972, Indianapolis should have checked with Washington.

All that remains is Indiana's argument that the Departmental Appeals Board misinterpreted the law. Acting for the President, the Bureau of Budget issued a circular specifying reimbursable expenditures for all federal grant programs. Agencies charged by statute with particular programs adopted these government-wide rules as part of their own regulations. At the beginning of the audit period, the rules were contained in Budget Bureau Circular A-87. In 1973 the President transferred the rule-writing function to the General Services Administration, Executive Order No. 11,717, 38 Fed. Reg. 12,315 (1973), which promulgated Circular A-87 as a regulation. 45 C.F.R. §74.171 (1974). The GSA reissued Circular A-87 in 1974 without material change as Federal Management Circular 74-4. The Department of Health and Human Services, which acts for the entire national government in auditing claims for indirect costs (including pensions), has included Circular 74-4 in different versions of its own regulations. The current regulation is 45 C.F.R. §74.171(a), incorporating the circular by reference.

Part C.1 of Circular 74-4 provides:

> 1. *Factors affecting allowability of costs.* To be allowable under a grant program, costs must meet the following general criteria: . . .

> d. Be consistent with policies, regulations, and procedures that apply uniformly to both federally assisted and other activities of the unit of government of which the grantee is a part.

The auditor and a series of administrative bodies all determined that Indiana had not applied consistent standards to the IESD and other state agencies. They concluded that the IESD, as a part of the state government, must be compared with other state agencies—which used a 30-year period over which to amortize underfunding—rather than with units of local government using a 15-year period. They also observed that the legislature of Indiana had elected not to pay even the amount PERF thought essential to achieve full funding within 30 years. A comparison between actual payments by the IESD and actual payments by other state agencies made clear the lack of consistency.

Indiana attacks this decision on the ground that because the employees of the IESD have longer average tenure, a higher contribution rate is necessary to produce full funding. Yet HHS did not insist that Indiana use identical contribution rates. It concluded, rather, that Indiana had not derived its contribution rates by the use of consistent criteria. Indiana was not using different rates so that different agencies whose work forces had different age and tenure combinations could achieve full funding at the same time. Instead it set different amortization periods for the IESD and other agencies, and Indiana did not pay toward the pensions of state employees even the amounts called for by these different formulae. Paragraph C.1.d reflects a decision to protect the federal government by parity of treatment. Some states have higher wages than others; some have more generous pension plans than others; the federal government tracks these differences, allowing the state's willingness to pay out of its own pocket to supply vicarious representation to federal interests.

Whatever the state actually pays to state workers is the benchmark for measuring the federal government's

share. Indiana pays its public workers partly in cash and partly in promises. Indiana is free to make that choice for itself but may not claim 100% in cash up front from the federal government if it is unwilling to put the retirement program for other state employees on an equivalently well-funded basis. The federal government has a legitimate concern that Indiana will promise its employees the moon but pay less when a crunch comes—after having collected enough from the federal government to pay the whole amount to the employees at the IESD. Even though the state puts the full faith and credit of Indiana behind PERF's obligations, including those to employees of the IESD, Indiana could choose to make the pension formula less generous. That would cut the state's future pension contributions, after the federal government had paid in full according to today's formula. Perhaps Indiana would be tempted to use the excess in the IESD's account with PERF to fund the benefits of other workers. (HHS believes that it is already doing so in the way it apportions investment income within PERF; Indiana denies the charge, and we need not determine who is right.)

If Indiana wants to top up the retirement account available to the IESD, it has only to adopt the same formula for (other) state workers. This could come to grief if Indiana moves toward full funding during a time of prosperity (the most tempting time to top up a pension plan). Prosperity means low unemployment, which means fewer workers at the IESD: its employment is countercyclical. In boom times the federal government makes less money available to fund the administration of unemployment bureaucracies. So when Indiana decides to catch up for itself, it may have trouble catching up for the IESD. In the worst case, the federal government would discontinue all payments under §502, leaving Indiana to fill the IESD account from the state's budget. Such possibilities produce sympathy with the state's argument that comparable treatment should mean comparable promises: a state treats federally-funded and state-funded workers consistently when it promises each the same pension formula

and ensures (by pledging the state's full faith and credit) that these promises will be kept. All the state wants is the actuarial value of that promise from the federal government now, securing its position against the possibility that the national government's role in funding will shrink. From this perspective, how the state apportions its own payments over time would be irrelevant.

Whatever the attractions of this position to the states, it would be a nightmare for the federal government—which would find computations of state and federal shares much harder to make, and would face the specter (discussed above) of states cutting back on pensions after the federal government has paid. We deal here with the interpretation of a government-wide regulation by the agency charged with implementing this rule for the entire national government. Agencies possess substantial latitude to interpret their regulations, *United States v. Larionoff*, 431 U.S. 864, 872 (1977); *Udall v. Tallman*, 381 U.S. 1, 16-17 (1965); *Homemakers North Shore, Inc. v. Bowen*, 832 F.2d 408, 411-12 (7th Cir. 1987), even regulations initially drafted elsewhere in the government. *Pauley v. BethEnergy Mines, Inc.*, 59 U.S.L.W. 4778, 4782-83 (U.S. June 24, 1991). Section 502 allows the Secretary to set a reimbursement policy—that is, to exercise judgment. That judgment is exercised, and the policy made, in the course of interpretation. HHS did not overstep permissible bounds when concluding that safety for federal taxpayers lies in consistent rules for determining cash contributions to pension funds, rather than consistent rules for determining the pension entitlements of the workers.

AFFIRMED

A true Copy:

Teste:

Clerk of the United States Court of Appeals for the Seventh Circuit

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

BOARD OF TRUSTEES OF THE PUBLIC EMPLOYEES' RETIREMENT FUND OF THE STATE OF INDIANA, Plaintiff, v. LOUIS W. SULLIVAN, M.D., as Secretary of the Department of Health and Human Services of the United States of America, and THE UNITED STATES OF AMERICA, Defendants.	CAUSE NO. IP 82-1520-C

ORDER

This cause is before the Court on the defendants' motion for summary judgment pursuant to Rule 56 of the Federal Rules of Civil Procedure. Whereupon the Court, having examined the memoranda in support thereof and in opposition thereto, and being duly advised, hereby finds that no genuine issue of material fact exists and that the defendants are entitled to judgment as a matter of law on their counterclaim. Therefore, the defendants' motion for summary judgment is GRANTED.

The Court will not enter a final judgment until such time as an accurate calculation of the amounts due and owing

from plaintiff to defendants can be made. In this regard, the defendants are hereby ordered to submit, within thirty (30) days of the date of this order, a memorandum describing in detail their calculation of the appropriate amounts due and owing. This memorandum should include a calculation of prejudgment interest. The plaintiff shall have ten (10) days to respond to the defendants' memorandum. The defendants, in turn, shall have ten (10) days to reply to the plaintiff's memorandum.

IT IS SO ORDERED.

DATED: June 28, 1990

/s/ JAMES E. NOLAND
U.S. District Judge

MEMORANDUM ENTRY

This is an action for declaratory relief and for judicial review brought by the Board of Trustees of the Public Employees' Retirement Fund of the State of Indiana ("PERF") against the Secretary of the Department of Health and Human Services ("Secretary" or "HHS"). PERF, an agency of the state of Indiana, is charged with the administration of pension plans created for state and municipal employees. PERF seeks judicial review of the Secretary's audit disallowance of over $6 million in federal grant funds previously deposited with PERF to be paid to various federally assisted programs. Over $5 million of these federal funds were to be paid to the Indiana Employment Security Division ("IESD") pursuant to Title III of the Social Security Act, 42 U.S.C. 501 *et seq.*

The Secretary has made a formal demand for the return of the $6 million in federal funds that were allegedly overcharged to the federal government by PERF. In response, PERF has sought to invalidate the $6 million assessment at

various administrative hearings. The Secretary's position has been upheld at the administrative level. PERF now seeks a judgment declaring the $6 million assessment invalid. The United States of America has been joined as a defendant and has interposed a counterclaim against PERF to recover the same funds at issue in the main action plus accrued interest.

I. FACTUAL AND PROCEDURAL BACKGROUND

A. An Overview of the Public Employees' Retirement Fund (PERF) and the Indiana Employment Security Division (IESD)

The following description of PERF is contained in the HHS Audit Report dated June 2, 1980:

> The Public Employees Retirement Fund (PERF) was established in 1945 as both a fund and an agency in accordance with Indiana law. The purpose of the fund is to promote economy and efficiency in the administration of state and local government by providing for an orderly way for members to be retired. PERF is essentially a combination of a defined benefit plan supported by employer contributions and defined contribution plan supported by employee contributions. Retirement benefits are paid to officers and employees of the State and its political subdivisions after they fulfill a specified period of service under specified circumstances.
>
> . . .
>
> Approximately 720 units of government participate in PERF. Included are the State of Indiana, county welfare departments, school corporations and cities.

> As of June 30, 1978, the membership consisted of 106,231 active members and 16,298 retired and disabled members. Generally, all employees of the State and participating political subdivisions join PERF when they first report for work. However, an employee must join PERF after one year of employment as a condition of employment.

Defendants' Brief, Appendix, at 14.

Four different types of governmental organizations make contributions to PERF:

(1) state departments financed solely by state funds;
(2) state departments financed partially by federal funds and partially by state funds;
(3) one state department, the Indiana Employment Security Division, financed solely by federal funds; and
(4) municipalities and other state political subdivisions.

Id. at 57-58. The funds contributed to PERF by the various governmental units are combined only for administrative and investment purposes. PERF does not have a direct financial or proprietary interest in the funds deposited with it; rather, PERF holds such funds for the benefit of the employees of the state of Indiana who contribute to the fund.

The Indiana Employment Security Division (IESD) was created in 1936 under the Indiana Employment Security Act. The IESD is administered by the Indiana Employment Security Board, which consists of five members and a director appointed by the Governor. The IESD is a department of the State of Indiana; however, its operations are financed entirely with federal funds provided by the Department of Labor ("DOL"). *Id.* at 20. "Basic functions of the IESD include the collection of contributions from employers to provide funds for the payment of unemployment benefits, the payment of benefits to eligible unemployed workers, and the operations of the State's Employment Service." *Id.*

B. The HHS Audit

In 1979, the Department of Health, Education, and Welfare (the precursor to the Department of Health and Human Services or "HHS") conducted an audit of employer's contributions to PERF for the period from July 1, 1971, to June 30, 1978. On June 2, 1980, HHS issued an "Audit Report," which contained audit findings and recommendations. The HHS audit was specifically conducted in response to discrepancies found in earlier audits of other Indiana grant programs.

> [Those] audits conducted at various Indiana State Agencies disclosed inconsistencies between amounts charged for PERF on behalf of State employees working on Federally funded programs and those working on non-Federally funded programs. The audits disclosed that, prior to fiscal year 1976, the State of Indiana General Assembly appropriated funds for the employer contributions to PERF on State funded programs without considering the actuarially developed estimates of the amounts that were needed to fund the PERF liability. However, for employees who worked on Federally funded programs, the State used actuarial rates to fund the employer contributions and claimed the costs for reimbursement from Federal funds. The actuarial rates were higher than the effective rates. As a result, the Federal programs were charged for more PERF costs than the State funded programs.

Defendants' Brief, Appendix, at 14.

With regards to the federal grant funds deposited with PERF for the benefit of IESD, the HHS made the following findings.

> During the period July 1, 1971 to June 30, 1978, the Federal Bureau of Employment Security, Depart-

ment of Labor, was charged $10,324,483 for the employer's share of contributions to the Public Employees' Retirement Fund (PERF). The contributions were made on behalf of employees of the Indiana Employment Security Division (IESD), which administered the provisions of the Indiana Employment Security Act and related U.S. Department of Labor (DOL) programs. The amounts contributed, however, represented a higher percentage of salaries and wages than were contributed to the PERF for employees who worked on State and other Federally funded programs. As a result, [HHS] determined that the DOL was overcharged $5,049,837. [HHS has] recommended a financial adjustment in that amount.

. . .

The PERF liability for the IESD is calculated separately from all other PERF accounts. Prior to FY 1972, the unfunded liability of the State of Indiana and the IESD were compared each year to determine if the payments made by the IESD were funding the retirement reserves of their employees at the same rates at which the State of Indiana was being funded. A payment was made to PERF only when the percentage of the IESD unfunded liability exceeded the percentage of the State's unfunded liability. This enabled the IESD to maintain the funded portion of [its] PERF liability at the level of the other State departments and since the costs were consistent with other activities of the State government [it was] allowable for reimbursement from Federal funds in accordance with the provisions of [Federal Management Circular] 74-4, Section C.1.d.

The Federal Bureau of Employment Security, Division of Actuarial and Financial Services, Department of Labor reported, in a letter dated July 30,

1959, that [it was] in agreement with the concept that the IESD liability should be calculated separately from all other State government units and that, for administrative purposes, the IESD account should remain a separate individual retirement system which is part of a statewide system. DOL reported also this assured that funds granted by the Federal Bureau of Employment Security for the payment of IESD retirement costs would be used solely for that purpose and [it was] satisfied that the IESD was afforded fair and equitable treatment with respect to determining its liabilities and costs.

. . .

Notwithstanding the DOL's acceptance of the method for funding the PERF liability, IESD discontinued this practice in FY 1972 and began funding the liability by using separate rates developed by the fund's actuary. The rates were significantly higher than the effective contribution rates of the other State agencies as shown in the following schedule:

PERF Employer Contribution Rates

Fiscal Year	IESD	State of Indiana
1972	13.77%	4.98%
1973	13.77	4.76
1974 - 1st half	12.45	4.01
1974 - 2nd half	12.45	2.89
1975	10.16	3.62
1976	9.15	6.00
1977	8.54	6.00
1978	7.82	6.00

. . .

The increased rates for IESD were requested pursuant to the dictates of the PERF Board of Trustees. In a letter dated December 1, 1970, the Director of the IESD was informed that . . . since the State had not contributed a sufficient amount to PERF for many years, IESD's practice of paying PERF only if [its] unfunded liability exceeded the unfunded liability of the State would result in the depletion of [its] retirement account in approximately 3 years and 6 months. To avoid this eventuality, it was necessary for the IESD to increase [its] PERF contributions to a rate of 13.77 percent of gross payroll. The rate was an actuarially determined percentage that would, reportedly, amortize the unfunded liability over 15 years and also pay current costs accruing annually.

In the minutes of the PERF Board of Trustee's meeting which prompted this action it was stated that payment in accordance with the funds actuary was necessary to assure that IESD: "would in the future become funded on a comparable basis with all other participating municipalities in the fund." Thus, beginning in FY 1972, the IESD was treated as a political subdivision of the State rather than as one of its departments for the purpose of calculating contributions to PERF. However, since the IESD was established as a department of the State of Indiana, according to the Rules and Regulations of the Indiana Employment Board, it did not meet the criteria of a political subdivision which is defined by Indiana Code 5-10.3-1-6 . . . . Notwithstanding the need for increasing the PERF contributions of the IESD, the amount of costs that are allowable for reimbursement from Federal funds is subject to the provisions of [Federal Management Circular] 74-4 . . . . By using [its] own actuarial percentages, the IESD contributions to PERF were no longer consistent with the costs of other activities of the State government and IESD contributions in excess of amounts

> contributed by other State activities were unallowable for Federal reimbursement. For the period of July 1, 1971 to June 30, 1978, the unallowable PERF contributions by IESD amounted to $5,049,837.

Id. at 21-22.

In short, the HHS found that "the resulting PERF costs of IESD were no longer commensurate with the costs of the other departments" of the state after 1972. *Id.* at 17. Therefore, the HHS auditors recommended a disallowance of $5,049,837 in grant funds previously paid to PERF on behalf of IESD. *Id.* at 22. This sum equals approximately 50% of the the total federal grant funds paid to IESD for its pension costs during the period covered by the audit. In addition, the HHS auditors recommended a disallowance of $975,844 in federal grant funds overpaid to other departments of the state of Indiana. *Id.* at 26.

C. Federal Management Circular 74-4

Based on the 1980 audit, HHS determined that federal grant programs were overcharged over $6,000,000 by PERF. HHS concluded that the overcharges were the result of a violation of Federal Management Circular ("FMC") 74-4, which governs "cost principles applicable to grants and contracts with State and local governments." FMC 74-4 provides in pertinent part:

> C. *Basic guidelines.*
>
> 1. *Factors affecting allowability of costs.*
> To be allowable under a grant program, costs must meet the following general criteria:
>
> . . .
>
> d. Be consistent with policies, regulations, and procedures that apply uniformly to both federally assisted

> and other activities of the unit of government of which the grantee is a part.

Defendants' Brief, Appendix, at 5. In its audit report, HHS concluded that the procedures used by PERF after 1972 were not in compliance with FMC 74-4. *Id.* at 22. Specifically, HHS concluded that the procedures applied to the IESD account were not "consistent with" those applied to other state agencies. *Id.*

D. Prior Administrative Proceedings

At first, Harold J. Egenes, the Executive Secretary of PERF, agreed with the findings of the HHS auditors. In a letter to HHS dated January 11, 1980, Egenes wrote that PERF could "find no exceptions to the findings contained in the draft of the proposed report on your audit of employer contributions" to PERF. *Defendants' Brief*, Appendix, at 47. However, PERF later changed its position and challenged the findings of the HHS audit report.

On February 4, 1981, PERF raised its objections to the audit report to the HHS Director, Division of Cost Allocation, who was responsible for resolving challenges to the audit. On March 26, 1981, the HHS Director, Division of Cost Allocation, sustained and adopted the audit findings. PERF then appealed this administrative determination to the Principal Regional Official of HHS, who upheld the cost disallowance determination on July 31, 1981. Subsequently, PERF appealed this case to the Grant Appeals Board of the HHS.

The Grant Appeals Board, after conducting an evidentiary hearing on the record, issued its final decision on June 24, 1982. The Grant Appeals Board affirmed the prior administrative decisions, which had determined that PERF had overcharged the United States a sum of $6,025,681 for federal grant funds paid to PERF by HHS. The Grant

Appeals Board then ordered PERF to reimburse HHS for these overpaid grant funds.

On July 14, 1982, PERF brought suit in this Court seeking a declaratory judgment and judicial review of the decision of the Grant Appeals Board (HHS). In its "Complaint for Judicial Review and Declaratory Judgment," PERF asserts that "the decision of the Grant Appeals Board is arbitrary, capricious, an abuse of discretion and not in accordance with law...." On November 10, 1982, the United States of America ("USA") was made a party defendant in the present action. The USA has filed a counterclaim against PERF to recover $6,025,681 *plus accrued interest*, the amount of federal grant funds administratively disallowed by HHS and allegedly overcharged by PERF.

II. JURISDICTION

This Court has jurisdiction over the plaintiff's complaint pursuant to 28 U.S.C. § 1331 and 28 U.S.C. § 2201. *See State of Michigan, Department of Human Services v. Secretary of Health and Human Services*, 744 F.2d 32, 35 (6th Cir. 1984). In addition, this Court has jurisdiction over the defendants' counterclaim pursuant to 28 U.S.C. § 1346(c).

III. DISCUSSION

This cause is presently before the Court on the defendant's motion for summary judgment, which was filed pursuant to Rule 56(c) of the Federal Rules of Civil Procedure. Rule 56 states in pertinent part that summary judgment shall be granted forthwith if the pleadings and discovery "show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." In determining whether a genuine issue of material fact exists, this Court must view the record and all *reasonable* inferences drawn therefrom in the light most favorable to the non-moving party. *Spring v. Sheboygan Area School District*, 865 F.2d 883, 886 (7th Cir. 1989). Thus, this Court will

view the record and all reasonable inferences drawn therefrom in the light most favorable to the non-moving party, which in this case is PERF.

This case involves two separate assessments made by HHS as a result of the 1980 audit. First, HHS assessed PERF slightly over $5 million that HHS alleges was overpaid to PERF for IESD's retirement fund ("the $5 million assessment"). Second, HHS assessed PERF slightly under $1 million that HHS alleges it overpaid to PERF for the federal government's share of contributions to various state agencies whose retirement funds are partially funded by the federal government ("the $1 million assessment"). Both of the assessments were upheld by the Grant Appeals Board, the highest administrative level. In its complaint, PERF contends that the "decision of the Grant Appeals Board is arbitrary, capricious, an abuse of discretion and not in accordance with law."

PERF raises several specific objections to both the $1 million assessment and the $5 million assessment. First, PERF argues that HHS is barred from collecting either assessment on the basis of laches and that the administrative Hearing Officer was without authority to order payment of the assessments. The Court will refer to these arguments as "the preliminary issues." Second, PERF contends that the $5 million assessment should be barred on the basis of equitable estoppel and that the assessment is invalid because the Secretary's interpretation and application of the appropriate federal regulation, FMC 74-4, was improper. The Court will refer to these arguments as "the main issues."

A. Standard of Review of HHS Decision

In this case, the Court is asked to review a final decision of the Grant Appeals Board of the HHS.

> The standard of review under the Administrative Procedure Act is whether the decision of the Grant Appeals Board of the Department of Health and

> Human Services was arbitrary, capricious, an abuse of discretion or otherwise not in accordance with law.

State of Michigan, Department of Human Services v. Secretary of Health and Human Services, 744 F.2d 32, 35 (6th Cir. 1984). *See also Citizens to Preserve Overton Park, Inc. v. Volpe*, 401 U.S. 402, 414, 91 S.Ct. 814, 822 (1971) ("In all cases agency action must be set aside if the action was 'arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law' or if the action failed to meet statutory, procedural, or constitutional requirements."); *Colorado Department of Social Services v. Department of Health and Human Services*, 585 F.Supp. 522, 525-26 (D. Col. 1984). The Court first notes that "the Secretary's decision is entitled to a presumption of regularity." *Citizens to Preserve Overton Park*, 401 U.S. at 415, 91 S.Ct. at 823. Under the "arbitrary and capricious" standard, "the court must consider whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment." *Id.* Although this Court is required to engage in a substantial inquiry, "the ultimate standard of review is a narrow one." *Id.* "The court is not empowered to substitute its judgment for that of the agency." *Id.*

B. Preliminary Issues

1. Authority of Hearing Officer

The first argument raised by PERF is that the decision of the Hearing Officer who heard its initial appeal is invalid. *Plaintiff's Brief*, p. 17. George Bardahl, as acting Principal Regional Official of HHS, assigned William Moran as a Hearing Officer (pursuant to 45 C.F.R. Part 75.6(d)) for the purpose of hearing and deciding PERF's appeal from the decision of the HHS Director, Division of Cost Allocation. The Hearing Officer's decision was *signed* July 31, 1981; however, it was not *postmarked* until August 3, 1981. In the interim, on August 1, 1981, Bardahl's term as acting Principal Regional Official had expired.

PERF contends that a Hearing Officer's decision does not become effective when signed; rather, it becomes effective only when "transmitted" (*i.e.*, when postmarked). Therefore, PERF concludes, the decision of the Hearing Officer in the present case was not valid because it was not "transmitted" until after the acting Principal Regional Official's authority had expired.

In rejecting PERF's argument that the Hearing Officer lacked the authority to issue his decision, the Grant Appeals Board stated:

> We reject appellant's argument that the Hearing Officer did not effectively complete his delegated duty. The Hearing Officer's duty was to render his decision. His decision was officially completed upon his signature on July 31, 1981. . . . In rejecting appellant's argument, we find unpersuasive its contention that the postmark date is the effective date of the decision. We agree with the Agency that the postmark date is used as a means of verification, and not as determining the effective date of the decision.

Grant Appeals Board Decision, p. 11-12. This Court agrees with this analysis of the Grant Appeals Board. The Hearing Officer's decision became "official" when it was *signed*, not when it was mailed. *Cf. Marbury v. Madison*, 5 U.S. (1 Cranch) 137, 2 L.Ed. 60 (1803). Thus, the Court concludes that this decision of the Grant Appeals Board was not arbitrary or capricious.

2. Laches

Next, PERF argues that "the audit was not timely made and unjustly destroys the reliance interests of the state which were based on budgetary approvals for each of the years subject to the audit." *Plaintiff's Brief*, p. 16. PERF's basic argument is that, because it was required to retain its financial records for only a three year period, HHS is barred

from conducting an audit using financial records older than three years. This argument is unpersuasive.

Under federal regulations, "all programmatic records, supporting documents, statistical records, and other records of" federal grant fund recipients (such as Indiana) must be retained for at least three years from the date the recipient "submits to HHS its single or last expenditure report for that period." 45 C.F.R. §§ 74.20, 74.21, 74.22. However, 45 C.F.R. § 74.24 states:

> (a) *Records of grantees.* HHS and the Comptroller General of the United States, or any of their authorized representatives, shall have the right of access to any books, documents, papers, or other records of the grantee which are pertinent to the HHS grant, in order to make an audit, examination, excerpts, and transcripts.
>
> . . .
>
> (d) *Expiration of right of access.* The rights of access in this section shall not be limited to the required retention period [3 years] but shall last as long as the records are retained.

Thus, federal regulations state that HHS may inspect records older than three years old; indeed, it may inspect such records "as long as the records are retained."

Based on these federal regulations, the Grant Appeals Board concluded that HHS "was not precluded from auditing back beyond the three year record retention period" and that PERF was not prejudiced "by the lateness of this audit."[1] *Grant Appeals Board Decision*, p. 11. For the reasons set forth in the Decision of the Grant Appeals Board, this Court concludes that the Secretary's decision is not arbitrary or capricious. Thus, PERF's laches argument must fail.

The only two challenges raised by PERF to the $1 million assessment were laches and lack of authority of the hearing officer. Because this Court has concluded that both of these challenges lack merit, the $1 million assessment is sustained in its entirety. The Court will now consider the two additional challenges raised by PERF to the $5 million assessment.

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[1]PERF contends that it was prejudiced by "the lateness of this audit" because the delay "severely hampered the state in determining the indirect costs for which it had not billed the federal government and which would have offset the amount claimed by the audit." *Plaintiff's Brief*, pg. 17. This argument is specious. Federal regulations establish separate procedures whereby a state can bill the federal government for indirect costs. *See Transcript of Summary Judgment Hearing* (dated February 12, 1985), p. 35. PERF could have billed the federal government for indirect costs irrespective of the audit; for whatever reason, it has failed to do so. As the Hearing Officer stated: "[I]f the State feels that it has valid claims regarding indirect costs, it should file for these claims to the appropriate Federal agencies, considering the statutory timeframes involved." Decision of Hearing Officer, p. 4.

The issue of indirect costs is, as plaintiff concedes, not before the Court on review. *See Transcript of Hearings Before the Grant Appeals Board*, p. 11.

C. The Main Issues

1. Consistent Treatment Under FMC 74-4

The primary issue in this case is whether PERF complied with FMC 74-4 in determining federal contributions to the IESD retirement account. FMC 74-4 provides in pertinent part:

> To be allowable costs must . . . be consistent with policies, regulations, and procedures that apply uniformly to both federally assisted and other activities *of the unit of government of which the grantee is a part*. (emphasis added).

a. To What Unit of Government Should IESD be Compared?

In order to determine whether "consistent procedures" were used, this Court must first determine which "unit of government" IESD ("the grantee") is a part. HHS argues that IESD should be compared to other departments of the state in determining whether there has been consistent treatment.

On the other hand, PERF apparently makes two arguments with respect to what the proper comparison should be. First, PERF argues that IESD has long been recognized by HHS as a "separate entity" for retirement fund purposes, and that as a "separate entity" IESD cannot be compared to any other unit of government. Therefore, PERF contends, the provisions of FMC 74-4, which require "consistent" treatment, are not applicable to IESD. In making this argument, PERF relies heavily on a 1959 memorandum, which, PERF claims, supports its contention that the federal government has long recognized the separate entity status of IESD. Second, PERF argues that if it must be compared to another unit of government, then it should be compared to the state municipalities or political subdivisions.

The Grant Appeals Board agreed with HHS and concluded as follows:

> The Board finds that appellant's argument that IESD was a separate legal entity is not supported by the record. The testimony of both the former and present Assistant Executive Secretaries was that the only real difference between IESD and other State agencies was the fact that IESD was 100 percent federally funded.
>
> . . .
>
> We also do not agree with the appellant's argument that the 1959 memorandum recognized IESD as a separate legal entity. On its face, the section of the memorandum cited by appellant indeed appears to recognize the separate entity status of IESD. However, a complete reading of the 1959 memorandum makes it abundantly clear that the appellant's reliance on this single section is misplaced as it is taken completely out of context.
>
> The purpose of the memorandum was to look at methods of calculating IESD's equitable share of its retirement liability to be paid to PERF. The final recommendation given in the memorandum was that IESD should be accorded separate treatment for calculation purposes in determining its liability to PERF. However, this does not mean that IESD was to be separate and distinct in comparison to the other contributors to PERF. On the contrary, it is clear that the intent of the memorandum was to assure that the IESD was treated equitably *vis a vis* the other members of PERF. This can be seen in the recognition that under the method of calculation adopted for IESD in the memorandum an adjustment would have to be made to assure equal contributions of the PERF components. The memorandum states that:

> Under this set-up, it is also necessary to increase or decrease the funded portion of the IESD liability to the level of the other State departments.

As stated in the audit report, and not contested by appellant, an adjustment was made to IESD's contribution to assure that it was equal in amount to that of the other State departments, regardless of actuarial differences. Ironically, it was the underfunding[2] of the State departments and IESD's funding at that same level that precipitated IESD's funding shortage.

In conclusion, we find that the 1959 memorandum recognized that IESD's liability should be calculated separately, but IESD is not a separate legal entity. In addition, there is no other evidence in the record to support the conclusion that IESD is sufficiently separated as a legal entity to justify inconsistent treatment under the cost principles. On the contrary, the evidence shows that for all practical purposes IESD was a State department. Therefore, we find that IESD was not a separate legal entity.

. . .

IESD clearly does not meet the definition of a political subdivision as set out in the Indiana code. More importantly, except for the fact that IESD is 100 percent federally funded, IESD has all the indicia of a State agency. Since appellant has been unable to produce any evidence to distinguish IESD from other

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[2]With regard to the "underfunding" mentioned in the decision of the Grant Appeals Board, PERF states simply: "Suffice it to say, for several years the State was not appropriating money to PERF to fund the accrued liability of the state towards its retired employees." *Plaintiff's Brief*, p. 6.

> State agencies within PERF, we find that IESD's contribution should be compared to those State agencies.

Grant Appeals Board Decision, pp. 5-9 (citations omitted). This Court agrees with the decision of the Grant Appeals Board that, for purposes of applying FMC 74-4, IESD should be compared to other departments or agencies of the state and should not be compared to municipalities or political subdivisions. For the reasons set forth in the Grant Appeals Board's decision, the Court finds that IESD was not and is not a separate legal entity for purposes of applying FMC 74-4. Moreover, IESD does not meet the definition of a political subdivision as set forth in I.C. § 5-10.3-1-6. As stated by the Grant Appeals Board, "IESD has all the indicia of a State agency." *See* I.C. § 22-4-18-1 *et seq.* (1986); *see also Grant Appeals Board Decision*, p. 6. Finally, the Court notes that both PERF and the 1959 memorandum upon which it so heavily relies refer to the IESD as a "state department." *Plaintiff's Brief*, p. 7.

b. Was There Consistent Treatment Between IESD and the Other State Departments?

The next step in this Court's analysis is to determine whether the procedures used to calculate the contributions for IESD were "consistent" with those used to calculate the contributions for the other state agencies or departments. PERF argues that the procedures were consistent; HHS, of course, argues they were not.

In order to determine whether consistent procedures were applied to IESD and the other state agencies during the audit period (July 1971 through June 1978), it is helpful to review certain undisputed facts.

> Prior to 1972, IESD contributed to PERF at the same rate as the other State agencies. However, the State contribution level to PERF on behalf of the other

> State agencies was at an artificially low level as determined by the State legislature, because the State's appropriation was not in accordance with actuarially determined figures. Since IESD contributed at the same rate as other State agencies did under the appropriation, IESD, as well as the other State agencies, faced a serious shortage of funds and it became evident that the retirement account would be depleted in a short period of time. Because of actuarial factors, IESD would deplete its account more rapidly than others.
>
> To avoid this occurrence, appellant informed IESD that subsequent to 1972 IESD was to begin funding its PERF liability in accordance with an actuarially computed rate. The rate was developed using a 15 year amortization period which resulted in a significant increase in IESD's contribution to PERF. During the same period, the other State agencies continued to contribute to PERF based on State legislature appropriations, not actuarially computed amounts.

Grant Appeals Board Decision, p. 2. Thus, during the audit period, PERF used an actuarial rate to determine IESD's liability and used an appropriated rate (*i.e.*, whatever the Indiana Legislature appropriated) to determine the liability for all other state agencies. This resulted in the following contribution rates:

Fiscal Year	IESD	Other State Agencies
1972	13.77%	4.98%
1973	13.77	4.76
1974 - 1st half	12.45	4.01
1974 - 2nd half	12.45	2.89
1975	10.16	3.62
1976	9.15	6.00
1977	8.54	6.00
1978	7.82	6.00

One reason for the higher rates for IESD was that, starting in 1972, PERF changed the period over which the unfunded liability of the account was amortized. *See Transcript of Hearing before the Grant Appeals Board*, pp. 69, 85, 101, 102, 112. PERF changed the amortization period of IESD from 30 years to 15 years. This change made the amortization period of IESD comparable to the amortization period of municipalities and political subdivisions, which also used a 15 year amortization period. However, all other state agencies were treated as one unit and retained the 30 year amortization period. HHS contends that the use of different amortization periods for IESD and other state agencies results in inconsistent treatment.

PERF argues that the higher contribution rates for IESD are necessary because of the lower turnover rate for IESD employees. Lower turnover rates lead to higher retirement costs, which, in turn, necessitate higher contribution rates. HHS does not dispute that IESD has lower turnover rates, on average, than the other state agencies and that lower turnover rates lead to higher retirement costs. Rather, HHS states simply: "The point, however, is that the same procedures were not used for IESD as were used for all other departments." *HHS Brief before the Grant Appeals Board*, p. 3.

The Grant Appeals Board agreed with HHS and stated:

> We agree with [HHS] that appellant *did not use the same procedures*[3] in determining the contribution rates of the various components of PERF. Appellant has produced a great deal of evidence showing how actuarial formulas are developed and applied to the components of PERF. This presentation would be persuasive except for the fact that while the actuarial rate was applied to IESD, it was ignored for the other State agencies. The State agencies continued to pay at a rate arbitrarily determined by the State Legislature's appropriation process. In fact, Mr. Meno testified that the State agencies did not begin paying at the actuarially determined rate until July 1, 1981, a full 10 years after IESD.
>
> From 1972 on, IESD's contribution rate was computed based on an actuarially computed rate amortized over 15 years. On the other hand, the State agencies contributed, not on an actuarially determined rate, but on what the State legislature happened to appropriate. It is irrelevant that the same

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[3]In its brief, PERF states: "Nowhere in this provision is there a term that says or means the *same* contribution *rate* must be used for all retirement contributions. By ruling that FMC 74-4 actually says *rate* when it clearly does not, the decisions below have not interpreted the clear language, but have applied a personal meaning which is not supportable." *Plaintiff's Brief*, p. 12. PERF mistates the record. The Grant Appeals Board did *not* hold that the same rate had to be used in order to comply with FMC 74-4. Rather, the Grant Appeals Board held that the *procedures* used to calculate the different rates were not consistent. The Grant Appeals Board specifically stated: "Because of the way in which the Board decides this case, it is not necessary for the Board to decide the question of whether 'consistency' under FMC 74-4 necessarily requires the same rate to be used or federal programs." *Grant Appeals Board Decision*, p. 3 n. 4. *See also Transcript of Summary Judgment Hearing* (February 12, 1985), p. 36 (HHS is "not insisting upon the same rate. We are, under our regulations, insisting that we be treated uniformly . . . .").

> procedure of determining an actuarial rate is used when in fact that rate is ignored for the State agencies but applied to IESD. Consistency of treatment requires not only the use of the same procedures in determining the contribution rate, i.e., an actuarial determination, but also, the actual contribution in accordance with the actuarial determination. To require less would render the consistency requirement meaningless in its application.
>
> We likewise find appellant's arguments concerning the low turnover rate of IESD unpersuasive. It was undisputed that this lower turnover rate results in somewhat higher retirement costs. However, while the lower turnover rate contributed to IESD's funding problems, the major cause of IESD's problems was the consistent underfunding of its retirement liability prior to 1972 by paying at the same rate as the other State departments. It was not disputed that PERF's response to IESD's funding problems was actuarially sound. However, it was disparate treatment. While IESD began paying at an actuarially determined rate, the State agencies continued to pay at an appropriated rate that was far below the actuarial rate.

Grant Appeals Board Decision, pp. 8-9 (emphasis added).

This Court agrees with the well reasoned decision of the Grant Appeals Board. Consistent treatment was not given to IESD and the other state agencies. Beginning in 1972, IESD's unfunded liability was amortized over a 15 year period; the unfunded liability of the other state agencies was amortized over a 30 year period. This caused IESD's contribution rate to be much higher than the contribution rate of the other state agencies, which were treated as one unit in determining their rate. Moreover, during the audit period, HHS was required to pay (on behalf of IESD) into the PERF account at an actuarially determined rate, whereas the

other state agencies paid into the account whatever amount the Indiana Legislature happened to appropriate. These are examples of the use of inconsistent procedures used by PERF in calculating IESD's liability.

Based on the foregoing, the Court concludes that the Grant Appeals Board's decision to compare IESD to other state agencies or departments, and not to municipalities or political subdivisions, is not arbitrary or capricious. The Court also concludes that the Grant Appeals Board's finding that IESD and the other state agencies were not afforded consistent treatment under FMC 74-4 is not arbitrary or capricious.

2. Equitable Estoppel

The final issue raised by PERF is whether HHS should be equitably estopped from collecting on its assessments. PERF argues that "the IESD had long been recognized by the federal government as a separate entity for retirement fund contribution purposes," *Plaintiff's Brief*, p. 6, and that PERF reasonably relied on the 1959 memorandum referred to earlier in concluding that it had the Secretary's approval to use different contribution rates for IESD. Therefore, PERF contends, HHS should be estopped from collecting on its assessments.

As a general rule, a party's reliance on misinformation provided by an employee of the federal government does not provide the basis for an estoppel. *Crown v. United States Railroad Retirement Board*, 811 F.2d 1017, 1021 (7th Cir. 1987). However, "the doctrine of estoppel has been applied to the federal government in certain narrow exceptions." *Id.* The Seventh Circuit has elaborated on these "narrow exceptions" as follows:

> In cases involving the United States, estoppel is applicable if the government's actions constitute "affirmative misconduct" *and* if four additional re-

> quirements are satisfied. First, the party to be estopped must know the facts. Second, this party must intend that his conduct shall be acted upon, or must so act that the party asserting estoppel has a right to believe it is so intended. Third, the party asserting estoppel must have been ignorant of the facts. Finally, the party asserting estoppel must reasonably rely on the other's conduct to his substantial injury.[4]

United States v. Lair, 854 F.2d 233, 237-38 (7th Cir. 1988) (*quoting Pratte v. N.L.R.B.*, 683 F.2d 1038, 1041 (7th Cir. 1982)).

PERF's equitable estoppel argument must fail for three reasons. First, PERF has failed to allege or to show any "affirmative misconduct" on the part of a federal official. Second, PERF's reliance, if any, on the 1959 memorandum (containing excerpts from the so-called "Borus letter") was unjustified. The 1959 memorandum does not say, as PERF contends, that HHS approves the use of different treatment for IESD *vis-a-vis* the other state agencies. Rather, when read in its entirety, the 1959 memorandum states that HHS is agreeable to separate treatment for IESD *only if* separate treatment is afforded all other state agencies. Such treat-

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[4]In *Cheers v. Secretary of Health, Education, and Welfare*, 610 F.2d 463, 469 (7th Cir. 1979), the Seventh Circuit stated:

> Parties dealing with the Government are charged with knowledge of and are bound by statutes and lawfully promulgated regulations despite reliance to their pecuniary detriment upon incorrect information received from Government agents or employees. Failure to comply with the applicable statute and regulations precludes recovery against the Government "no matter with what good reason" the claimant believed she had come within the requirements. Estoppel will not lie regardless of the financial hardship "resulting from innocent ignorance."

Id. at 469 (*quoting Flamm v. Ribicoff*, 203 F.Supp. 507, 510 (S.D.N.Y. 1961)).

ment was never given to the other state agencies. Therefore, PERF's reliance on the 1959 memorandum was unjustified. Third, PERF's reliance on a 1959 memorandum to change its procedures thirteen years later, in 1972, is not reasonable. For these reasons, the Court concludes that HHS is not estopped from collecting on its assessments.

IV. CONCLUSION

For all of the foregoing reasons, the Court concludes that the decision of the Grant Appeals Board was neither arbitrary, capricious, an abuse of discretion, nor otherwise not in accordance with the law. The Court also concludes that there is no genuine issue of material fact and that the defendants are entitled to judgment as a matter of law. Accordingly, the defendants' motion for summary judgment is GRANTED.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

BOARD OF TRUSTEES OF THE PUBLIC EMPLOYEES' RETIREMENT FUND OF THE STATE OF INDIANA,	)	
Plaintiff,	)	
v.	)	CAUSE NO. IP 82-1520-C
LOUIS W. SULLIVAN, M.D., as Secretary of the Department of Health and Human Services of the United States of America, and THE UNITED STATES OF AMERICA,	)	
Defendants.	)	

JUDGMENT

On June 28, 1990, this Court issued an order granting defendants' motion for summary judgment on plaintiff's complaint. In that order, the Court also concluded that the defendants were entitled to judgment as a matter of law on their counterclaim; however, it declined to enter final judgment until an accurate calculation of the amounts due and owing to defendants could be made. The defendants have submitted an affidavit stating that the total amount due and owing is $11,360,367.05, and the plaintiff does not dispute defendants' calculation.

IT IS THEREFORE ORDERED, ADJUDGED, and DECREED that JUDGMENT be entered in favor of the defendants and against the plaintiff in the amount of $11,360,367.05, and that costs be borne accordingly.

DATED: August 9, 1990

/s/ JAMES E. NOLAND
U.S. District Judge

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

BOARD OF TRUSTEES OF THE PUBLIC EMPLOYEES' RETIREMENT FUND OF THE STATE OF INDIANA,	)	
Plaintiff,	)	
v.	)	CAUSE NO. IP 82-1520-C
LOUIS W. SULLIVAN, M.D., as Secretary of the Department of Health and Human Services of the United States of America, and THE UNITED STATES OF AMERICA,	)	
Defendants.	)	

STIPULATION FOR PAYMENT IN
PARTIAL SATISFACTION OF JUDGMENT

The Board of Trustees of the Public Employees Retirement Fund, State of Indiana (hereafter State) and the United States of America, on behalf of Louis W. Sullivan, M.D., Secretary of Health and Human Services (hereafter HHS), hereby agree and stipulate as follows:

1. That the State does not contest, nor appeal from, the part of the judgment entered on August 9, 1990, as it relates to the HHS assessment against non-Indiana Employment Security Division (non-ISED) grant monies.

2. That the State has offered to pay Nine Hundred Seventy Five Thousand Eight Hundred Forty-Four Dollars ($975,844.00) plus prejudgment interest on said amount of Eight Hundred Sixty Three Thousand Nine Hundred Thirty-Nine Dollars ($863,939.00), plus post judgment interest of Twenty Seven Thousand Four Hundred Six Dollars and 23/100 ($27,406.23), for a total payment of One Million Eight Hundred Sixty-Seven Thousand One Hundred Eighty-Nine Dollars and 23/100 ($1,867,189.23) as partial satisfaction of the August 9, 1990, judgment as it relates to the non-ISED assessments.

3. That HHS has agreed to accept said payment in partial satisfaction of judgment. Said acceptance shall not in any way impair or diminish the rights of HHS to the remaining judgment balance of Nine Million Five Hundred Twenty Thousand Five Hundred Eighty-Four Dollars and 05/100 ($9,520,584.05), subject to the outcome of the appeal to the Seventh Circuit Court of Appeals.

4. That said payment does not waive or estop any party from pursuing its appellate rights with regards to the August 9, 1990, judgment presently on appeal to the Seventh Circuit Court of Appeals in a cause captioned *Board of Trustees of the Public Employees Retirement Fund of the State of Indiana v. Louis W. Sullivan. M.D. et al.*, Cause No. 90-3010.

All of which is stipulated and agreed to this 17th day of October, 1990.

On behalf of the Board of Trustees of the Public Employee's Retirement Fund, State of Indiana.

Linley E. Pearson
Attorney General

/s/ By: Michael Schaefer
Deputy Attorney General

On behalf of Louis W. Sullivan, M.D., Secretary of Health and Human Services, United States of America.

DEBORAH J. DANIELS
UNITED STATES ATTORNEY
Southern District of Indiana

/s/ By: Thomas E. Kieper
Assistant United States Attorney

DEPARTMENT OF HEALTH AND HUMAN SERVICES

DEPARTMENTAL GRANT APPEALS BOARD

Department of Health and Human Services

SUBJECT: Indiana Public Employees' Retirement Fund
Docket No. 81-141
Decision No. 314

DATE: June 24, 1982

DECISION

The State of Indiana Public Employees' Retirement Fund (appellant) appealed the decision of William C. Moran, Hearing Officer,[1] regarding contributions to the Public Employees' Retirement Fund (PERF) for the years 1972 through 1978.

In dispute is $6,025,681, which includes the following items: (1) $5,049,837 that the Indiana Employment Security Division (IESD) contributed to PERF; and, (2) $975,844 paid by other federally supported programs to PERF. Appellant raised a number of legal and factual arguments in support of its appeal, as noted below, but not all of the arguments pertain to both parts of the disallowance.

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[1]The Hearing Officer was designated by the Acting Principal Regional Official of HHS to review appellant's appeal pursuant to 45 CFR Part 75 from the determination of the Director, Division of Cost Allocation, Region V. Section 75.6(d) of Title 45 CFR provides for review by the Regional Director (formerly the Principal Regional Official) or his delegate. When we refer to the "respondent" or "Agency" in this decision, we mean any of the following: the Regional Director of Region V; the Director, Division of Cost Allocation; or the Hearing Officer.

For reasons discussed below, we sustain the Hearing Officer's decision. Our decision is based on briefing and documents submitted by the appellant and the respondent, and the transcript of a hearing conducted by the Board, in this case. Neither party wished to file post-hearing briefs.

I. Background

PERF was established in 1945 as both a retirement fund and an agency in accordance with Indiana law. Four different types of organizations contribute to PERF:

1. State departments financed solely by State funds;
2. State departments financed partially by federal funds and partially by State funds;
3. One department financed solely by federal funds (IESD); and,
4. Municipalities and other State political subdivisions.

IESD's operations are 100 percent federally financed. Prior to 1972, IESD contributed to PERF at the same rate as the other State agencies. However, the State contribution level to PERF on behalf of the other State agencies was at an artificially low level as determined by the State legislature, because the State's appropriation was not in accordance with actuarially determined figures. Since IESD contributed at the same rate as other State agencies did under the appropriation, IESD, as well as the other State agencies, faced a serious shortage of funds and it became evident that the retirement account would be depleted in a short period of time. Because of actuarial factors, IESD would deplete its account more rapidly than others.[2]

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[2]The audit report states that the fund would have been depleted in approximately three years, six months. Joint Appeal File (JAF), p. 53. The present Assistant Executive of PERF, Steven Meno, testified that IESD's account would have been depleted in one and one-half years. Transcript (Tr.), p. 69.

To avoid this occurrence, appellant informed IESD that subsequent to 1972 IESD was to begin funding its PERF liability in accordance with an actuarially computed rate. The rate was developed using a 15 year amortization period which resulted in a significant increase in IESD's contribution to PERF. During the same period, the other State agencies continued to contribute to PERF based on State legislature appropriations, not actuarially computed amounts.

Federal audits conducted on various State agencies disclosed that the federal government was contributing through IESD at an actuarial rate that was higher that the amounts appropriated by the State legislature. Therefore, the Department of Health and Human Services as the lead audit agency conducted an audit of the entire PERF agency. The audit covered the period from July, 1971 through June 30, 1978.

Pursuant to the audit report (JAF, pp. 42-77), the Agency determined that federal contributions on behalf of IESD to PERF at the actuarial rate exceeded by $5,049,837 the amount that would have been contributed if the State appropriation rate had been used. In addition, the Agency determined that federal contributions on behalf of other federal employees working State departments were excessive in the amount of $975,844.

The Agency's determination was based on the provisions of Federal Management Circular (FMC) 74-4, Section C.1.d.[3] Those provisions provide that:

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[3] The U.S. Department of Health, Education, and Welfare (HHS' predecessor) published this provision as a regulation. 45 CFR Part 74, Appendix C, Part I, C.1.d., first published on September 19, 1973, 38 Fed. Reg. 26275.

1. Factors affecting allowability of costs:

   to be allowable under a grant program, costs must meet the following general criteria:

   d. Be consistent with policies, regulations, and procedures that apply uniformly to both federally assisted and other activities of the unit of government of which the grantee is a part.

The Agency determined that appellant's computation of IESD's rate of contribution to PERF in accordance with an actuarial study was inconsistent with the State's appropriation method of contributing to PERF, and therefore represented inconsistent treatment of federally-funded and non-federally-funded activities.[4]

II. Discussion

A. Whether the federal contributions were consistent with State contributions

Appellant did not contest that the provisions of FMC 74-4, Section C.1.d. apply to this dispute or that a separate rate was used in calculating IESD's contribution to PERF. Appellant contended, however, that its use of a separate rate for IESD was appropriate under the circumstances as they existed. Appellant advanced two arguments in support of its position.

[4] The Agency later argued that "consistency" under FMC 74-4 also actually requires the same rate of contribution, versus the same procedures used in determining the rate, be charged to the federal government. *See*, Tr., pp. 14-16. The Agency contended that two previous Board decisions, State of Connecticut, Decision No. 8, February 7, 1975 and State of Rhode Island, Decision No. 29, December 6, 1976, support such an interpretation. *Id.* Because of the way in which the Board decides this case, it is not necessary for the Board to decide the question of whether "consistency" under FMC 74-4 necessarily requires the same rate be used for federal programs.

Appellant first contended that IESD was recognized as a separate legal entity for retirement fund purposes. Appellant is apparently arguing that the consistency of treatment requirement of FMC 74-4 has no application to IESD, as a separate entity, since IESD's unfunded liability could not be compared against that of another entity.[5]

Appellant asserted that as far back as 1959 the federal government recognized the separate entity status of IESD. Appellant Brief, p. 4. Appellant cited portions of a July 30, 1959 memorandum which discussed the treatment of IESD in relation to the other members of PERF, JAF pp. 16-19, and contended that the memorandum confirmed the appellant's position that IESD is a separate individual retirement system. Appellant cited the following excerpt from the memorandum to support its position.

> We agree with the position taken in the 1945 Borus letter, that the ES agency liability be calculated separately from all other units. We recommend that this be continued .... Consequently, the ES account will in fact remain a separate individual retirement system which is part of a statewide system only for administrative purposes. This will assure that funds

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[5]This argument of the State, and to a substantial extent the response to the argument by the Agency, appear to reflect an assumption that treating IESD as a separate entity would somehow *ipso facto* lead to the conclusion that associated costs would escape the problem of consistency argued by the Agency here. Presumably, this assumption reflects a view that the scope of the area within which there must be consistency would be constrained by the limits of the "separate entity." On its face, we do not necessarily agree. It appears that there still would be a question of whether the costs of the "separate entity" needed to be treated consistently with similar costs of other "separate entities" within the State. The parties gave little attention to this issue, and given that we conclude that IESD was not a separate entity as the State would have it be considered, we need not develop this issue.

> granted by the Federal Bureau of Employment Security for payment of the ES agency's retirement costs will be used solely for that purpose.

JAF, p. 19.

Respondent asserted that finding IESD as a separate entity would not be dispositive of this case. Tr., pp. 17-18. Respondent argued that IESD would still have to conform to the consistency requirements of FMC 74-4. *Id.* at p. 18.

Respondent contended, however, that even if a finding of IESD as a separate legal entity would be dispositive of this case, that is not the situation here. Respondent disputed appellant's interpretation of the 1959 memorandum. Respondent contended that the memorandum, when read in its entirety, stood for the proposition that if you compute IESD's unfunded liability separately, then you must calculate the liability of all other components of PERF separately to accord consistent treatment. Respondent Brief, p. 2; *see also*, Tr., p. 120. Respondent argued that one rate was used for IESD and only one rate for all other State agencies and, therefore, appellant did not comply with the terms of the memorandum. *Id.*

Respondent also contended that IESD's contributions to PERF became part of a homogeneous fund. Respondent argued that this indicated that the State recognized IESD as part of PERF, and not as a separate entity.

The present Assistant Executive Secretary of PERF, Steven Meno, testified that IESD's contribution to PERF did not become part of a homogeneous fund, but instead was segregated. Tr., p. 74. He stated that:

> Separate ledger sheets are [kept] showing all revenue and expenditure items for the Employment Security Division.

Id. at pp. 74-75.

He stated that the funds were commingled for investment purposes only. *Id.* at p. 75.

On cross-examination Mr. Meno conceded, however, that the additional interest earned from the infusion of federal dollars as a result of the higher contribution rate of IESD benefited all of the participants of PERF, not just IESD. *Id.* at p. 84.

The Board finds that appellant's argument that IESD was a separate legal entity is not supported by the record. The testimony of both the former and present Assistant Executive Secretaries was that the only real difference between IESD and other State agencies was the fact that IESD was 100 percent federally funded. *See*, Tr., pp. 32, 82.

The former Assistant Executive Secretary acknowledged on cross-examination that IESD employees received their paychecks from the State of Indiana, received the same vacation benefits, same paid holidays, same sick benefits, and same pension benefits as State employees, and were subject to the same FICA withholding. *See*, Tr., pp. 29-31. These factors, although not dispositive of this issue, are persuasive indicia of IESD being an agency of the State. Furthermore, there is no evidence in the record to show that IESD's employees are treated differently from State employees.

We also do not agree with the appellant's argument that the 1959 memorandum recognized IESD as a separate legal entity. On its face, the section of the memorandum cited by appellant, *see*, p. 3 of decision, indeed appears to recognize the separate entity status of IESD. However, a complete reading of the 1959 memorandum makes it abundantly clear that appellant's reliance on this single section is misplaced as it is taken completely out of context.

The purpose of the memorandum was to look at methods of calculating IESD's equitable share of its retirement liability to be paid to PERF. *See*, JAF, p. 16. The final recommendation given in the memorandum was that IESD should be accorded separate treatment for calculation purposes in determining its liability to PERF. However, this does not mean that IESD was to be separate and distinct in comparison to the other contributors to PERF. On the contrary, it is clear that the intent of the memorandum was to assure that IESD was treated equitably *vis a vis* the other members of PERF. This can be seen in the recognition that under the method of calculation adopted for IESD in the memorandum an adjustment would have to be made to assure equal contributions of the PERF components. The memorandum states that:

> Under this set-up, it is also necessary to increase or decrease the funded portion of the [IESD] liability to the level of the other State departments.

JAF, p. 19.

As stated in the audit report, and not contested by appellant, an adjustment was made to IESD's contribution to assure that it was equal in amount to that of the other State departments, regardless of actuarial differences. *See*, JAF, p. 52. Ironically, it was the underfunding of the State departments and IESD's funding at the same level that precipitated IESD's funding shortage.

In conclusion, we find that the 1959 memorandum recognized that IESD's liability should be calculated separately, but IESD is not a separate legal entity. In addition, there is no other evidence in the record to support the conclusion that IESD is sufficiently separated as a legal entity to justify inconsistent treatment under the cost principles. On the contrary, the evidence shows that for all practical purposes IESD was a State department. Therefore, we find that IESD was not a separate legal entity.

B. Whether the State complied with the consistency requirements of FMC 74-4

Appellant contended that the "consistency" requirement in FMC 74-4, Section C.1.d. should be interpreted as requiring that:

> a uniform 'procedure' be applied across the spectrum of public employment to determine the potential retirement liability.

Appellant Brief, p. 7.

Appellant contended that, with regard to the funding levels of PERF, a uniform procedure was used in determining the contribution rates of the different components of PERF.

Appellant asserted that separate actuarial rates were computed for the individual components of PERF. Mr. Meno testified that a formula (*see*, JAF, p. 41) for computing the contribution rate of an employer is devised and applied to all components of PERF. Tr., p. 67. Mr. Meno described the process of developing the formula as follows:

> [Y]ou are looking at each and every individual employee, their date of hire, their salary, their current age, how many years they potentially could work, and from this, using a consistent procedure of a uniform cost method, which we are required to follow by statute, we develop what the accrued liability is.

Id.

Mr. Meno testified that the application of this formula from year to year to a given department can result in a different contribution rate. *Id.* He stated, for example, that in 1971 IESD's contribution rate was 13.77%, while in 1981 it was 7.25%. *Id.* at p. 68. He stated this is because certain

actuarial assumptions are reviewed and revised on a yearly basis. *Id.* He stated that, for example, salaries and interest may require adjusting so that "your target is reached so that in this case the liability is funded at the end of the period." *Id.*

Appellant contended that the higher contribution rate of IESD as compared to other State departments was the result of a lower turnover rate among IESD's employees and the corresponding longevity of its employees. Appellant submitted a series of charts and graphs which allegedly show a substantial difference in the turnover rates between IESD and other State departments. *See*, JAF, pp. 33-40. Appellant argued, and the respondent does not contest, that the lower turnover rate results in a higher liability for retirement fund purposes. Appellant Brief, p. 8. To meet this increased liability, appellant contended that it was necessary to fund IESD on a shorter amortization period.

Respondent contended that the State's treatment of IESD was inconsistent with its treatment of other State agencies. Respondent argued that while IESD's unfunded liability was determined on an actuarially calculated basis over a 15 year period, all other State agencies were amortized over a 30 year period and actually contributed based on an appropriation from State legislature. Respondent Brief, p. 3. This appropriation was consistently below the amount needed to fund the retirement program. Respondent argued that the use of different amortization periods is inconsistent treatment.

Respondent did not take issue with the lower turnover problem of IESD, which resulted in higher retirement costs, but stated simply that:

> The point, however, is that the same procedures were not used for IESD as were used for all other departments . . . .

Respondent Brief, p. 3.

Appellant contended that IESD's amortization period of 15 years is not unique as municipalities within the State were also on a 15 year amortization period. Apparently, appellant was arguing that IESD could be compared to municipalities for purposes of the "consistency" requirement.

Respondent argued that IESD did not meet the definition of a political subdivision as defined in the State of Indiana code and, therefore, IESD could not be compared to State municipalities for purposes of meeting the FMC 74-4 consistency requirement. *See*, Respondent Brief, p. 1.

We agree with respondent that appellant did not use the same procedures in determining the contribution rates of the various components of PERF. Appellant has produced a great deal of evidence showing how actuarial formulas are developed and applied to the components of PERF. This presentation would be persuasive except for the fact that while the actuarial rate was applied to IESD, it was ignored for the other State agencies. The State agencies continued to pay at a rate arbitrarily determined by the State legislature's appropriation process. In fact, Mr. Meno testified that the State agencies did not begin paying at the actuarially determined rate until July 1, 1981, a full 10 years after IESD. Tr., p. 78.

From 1972 on, IESD's contribution rate was computed based on an actuarially computed rate amortized over 15 years. On the other hand, the State agencies contributed, not on an actuarially determined rate, but on what the State legislature happened to appropriate. It is irrelevant that the same procedure of determining an actuarial rate is used when in fact that rate is ignored for the State agencies but applied to IESD. Consistency of treatment requires not only the use of the same procedures in determining the contribution rate, i.e., an actuarial determination, but also, the actual contribution in accordance with the actuarial determination. To

require less would render the consistency requirement meaningless in its application.

We likewise find appellant's arguments concerning the low turnover rate of IESD unpersuasive. It was undisputed that this lower turnover rate results in somewhat higher retirement costs. However, while the lower turnover rate contributed to IESD's funding problems, the major cause of IESD's problems was the consistent underfunding of its retirement liability prior to 1972 by paying at the same rate as the other State departments. It was not disputed that PERF's response to IESD's funding problems was actuarially sound. However, it was disparate treatment. While IESD began paying at an actuarially determined rate, the State agencies continued to pay at an appropriated rate that was far below the actuarial rate.

We find unpersuasive appellant's argument that IESD's 15 year amortization period is consistent with that of the State municipalities.[6] As respondent argued, and appellant did not contest, IESD clearly does not meet the definition of a political subdivision as set out in the Indiana code. More importantly, except for the fact that IESD is 100 percent federally funded, IESD has all the indicia of a State agency. Since appellant has been unable to produce any evidence to distinguish IESD from other State agencies within PERF, we find that IESD's contribution should be compared to those State agencies. As discussed above, those contributions were computed differently that that of IESD and, therefore, were inconsistent.

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[6]Even if we were to accept the appellant's argument, the record suggests that at least for the years prior to 1972 there was inconsistent treatment between IESD and the municipalities.

C. Additional Arguments

Appellant raised two technical legal arguments which pertained to both parts of the disallowance.

1. The Timeliness of the Audit

Appellant contended that the audit of other federally supported programs went back six years - double the three year period appellant was required to keep financial records and documents under FMC 74-4. Appellant argued that it was prejudiced by the lateness of the audit. Appellant asserted that an example of such prejudice is that it could not recover a letter from the U.S. Labor Department which approved its 1972 budget. Appellant Brief, p. 12. Appellant contended that this budget approval letter operated as an approval of the costs in question. *Id.* at p. 11.

Appellant also argued that the lateness of the audit hampered its collection of indirect costs which could have offset the amount of the disallowance. *Id.* at p. 12. Appellant later conceded that this issue is not appropriately before the Board. Tr., p. 11.

Respondent contended that federal regulations do not restrict the government's right to audit the three year record retention period. Respondent Brief, p. 5. Respondent argued that, to the contrary, 45 CFR 74.24 (d) provides that the right of access "shall last as long as the records are retained." *Id.*

Respondent argued that appellant was not prejudiced by its inability to retrieve the Labor Department's 1972 budget approval letter because:

> approval of a budget by the Federal government does not mean prior approval of costs claimed in a manner that is not in accordance with the Federal regulation.

Id.

In addition, the Agency argued that there is nothing in the record to indicate that the Labor Department was aware of the change in IESD's amortization rate which resulted in its increased contribution rate. Tr., p. 121. Therefore, any approval of the budget would not operate as an approval of IESD's higher contribution rate. *Id.*

FMC 74-7 states that a grantee must maintain its records for a minimum of three years. There is no corresponding obligation placed on the federal government to conduct its audit within the three year period.

In the absence of any prejudice shown by appellant by the lateness of this audit, we find that respondent was justified in auditing beyond the three year retention period.

We find unpersuasive appellant's argument that it was prejudiced by its inability to locate its 1972 budget approval letter from the U.S. Labor Department. Appellant did not allege that Labor Department officials were aware of the change in procedures used to calculate IESD's contribution rate to PERF, nor does the record reflect such knowledge. In the absence of such information, we find that the Labor Department did not give prior approval to the increased contribution rate of IESD and, therefore, appellant was not prejudiced by its inability to produce the 1972 budget approval letter. Since appellant has produced no other evidence of prejudice from the late audit, we conclude that the Agency was not precluded from auditing back beyond the three year record retention period.

2. Whether the Hearing Officer's Authority Had Expired

Appellant argued that the Hearing Officer's decision was not effective because he did not effectively complete his delegated duty prior to the expiration of the Acting Principal

Regional Official's authority. Appellant Brief, p. 13. Appellant argued that the postmark date of the decision, August 3, 1981, was the effective date of the decision. *Id.* Appellant asserted that the Principal Regional Official assumed office on August 1, 1981. Therefore, appellant argued that although the decision was signed July 31, 1981 it was not effective because it was mailed after the assumption of office by the new Principal Regional Official. *Id.* at p. 14. Appellant contended that its argument is supported by various federal regulations which use the postmarked date as the effective date. Appellant cited 45 CFR 75.5 as an example. *Id.*

The Agency contended that the federal regulations cited by appellant use the postmark date to "establish a convenient verifiable reference point . . . ." Agency Brief, p. 6. The Agency argued that the use of the postmark date in this manner had no effect on the authority of the Hearing Officer. *Id.* In addition, the Agency alleged that the signed decision was forwarded to the Agency's mailroom on July 31, 1981 for transmittal to appellant. *Id.*

We reject appellant's argument that the Hearing Officer did not effectively complete his delegated duty. The Hearing Officer's duty was to render his decision. His decision was officially completed upon his signature on July 31, 1981. Since the new Principal Regional Official did not assume office until August 1, 1981, the Hearing Officer successfully completed his duties during the delegator's (the Acting Principal Regional Official) term of office.[7]

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[7]While it does not appear that a delegation of authority of this type is necessarily extinguished simply because the acting official is replaced by the individual actually appointed to the position in question, we find it unnecessary to decide this question here since we consider the Hearing Officer's decision to be effective upon its issuance on July 31, 1981.

In rejecting appellant's argument, we find unpersuasive its contention that the postmark date is the effective date of the decision. We agree with the Agency that the postmark date is used as a means of verification, and not as determining the effective date of the decision.

Conclusion

For the reasons stated above, we find that appellant calculated federal and State contributions to PERF inconsistently. We also find that appellant we not prejudiced by the lateness of the federal audit and that the Hearing Officer's decision was rendered prior to the expiration of his authority. We therefore sustain the Agency's disallowance of $6,025,681.

Cecilia Sparks Ford

Norval D. (John) Settle

Alexander G. Teitz
Presiding Board Member